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BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
AMERICAN CAN COMPANY)

Appearances:

For Appellant: Bruce Casey, Attorney at Law

For Respondent: Burl D. Lack, Chief Counsel; Crawford H. Thomas, Associate Tax Counsel

O P I N I O N

This appeal by American Can Company is made pursuant to Section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying Appellant's protests against proposed assessments of additional franchise taxes in the amounts of $5,071.09, $3,501.86, $187.87 and $575.52 for the income years 1946, 1947, 1948 and 1949, respectively.

Appellant is a New Jersey corporation with its principal offices in New York, It manufactures and sells tin cans, packages and metal receptacles of all kinds, fibre containers and metalware goods. It manufactures these items in plants located throughout the United States and in Canada and Hawaii. In 1946 seven of these plants were located in California and in 1949 eight were located in California, Appellant also leases machines to its customers for sealing cans purchased from it,

Appellant is qualified to do business in California and during the income years involved herein it filed franchise tax returns in which it reported the income from its operations. It apportioned part of this income to California by the use of the usual three factor allocation formula. The Franchise Tax Board, for the income years 1946 and 1947, combined the income of Appellant with that of three of its wholly owned subsidiaries, American Can Company Southern, American Key Can Company and American Can Company, Ltd., and allocated a portion of the combined income to California. For the income years 1948 and 1949, the Franchise Tax Board similarly combined the income of Appellant with that of American Key Can Company and American Can Company, Ltd., and allocated a portion of the combined income to California. American Can Company Southern

was liquidated and merged with Appellant in 1947. Appellant protested the action of the Franchise Tax Board only to the extent that it had included the income of American Can Company, Ltd., in the combined income.

American Can Company, Ltd. (hereinafter referred to as "Canadian Company"), a corporation organized under the laws of Canada, manufactured and sold containers and leased machines for closing containers, Its sole factory was at Vancouver, B. C., and its operations were confined to the province of British Columbia, Appellant owned all of the stock of the Canadian Company, except for directors' shares. In 1950 the Canadian Company was liquidated and merged with Appellant,

During the period involved in this appeal, three of the five Canadian Company directors were officers of Appellant and some, but not all, of the Canadian Company officers were also officers of Appellant;' The same individual was the president of both Appellant and the Canadian Company,

The material for the metal containers manufactured by Appellant and its subsidiaries was tin plate, the major source of supply of which was in the United States. The Canadian Company made its purchases of this material through the Appellant in order to take advantage of Appellant's contractual arrangements with tin plate suppliers, The Canadian Company, however, paid the suppliers directly, The Canadian Company leased can closing machines to the purchasers of its finished products and these machines were acquired from Appellant at cost, The aggregate value of these machines, at cost, during the years 1946 to 1949, inclusive, was $3,754,790.49. Certain other minor items, which it did not manufacture, were also purchased by the Canadian Company from Appellant.

Appellant furnished to the Canadian Company business "know how", in the way of ideas and systems for manufacturing, selling, and accounting, The-Canadian Company paid Appellant for these services by assuming a portion of the total administrative and closing machine costs according to the ratio between the individual manufacturing costs of the two companies, and a portion of the total indirect sales expenses according to the ratio between their individual direct selling costs.

Appellant maintained a patent department and various research laboratories and these facilities were made available to the Canadian Company as well as to the other subsidiaries and branches.

The main issue presented in this appeal is whether Appellant and the Canadian Company were engaged in a unitary

business. The Franchise Tax Board asserts that they were. The Appellant argues that they were not because the California transactions of the Appellant were neither dependent upon, nor did they contribute to the operations of the Canadian Company. It also argues that the fact that the Canadian Company was subject to the laws of a foreign country precluded it from being treated as part of the unitary business of the parent. And, finally, it argues that the application of the unitary business theory to affiliated corporations, particularly when the affiliated corporation is organized and operating under the laws of a foreign country, violates the State and Federal Constitutions and a treaty between the Federal Government and Canada,

The propriety of the application of the unitary business theory to affiliated corporations is too clearly established in this State for Appellant to prevail on its constitutional argument. Thus in Edison California Stores, Inc. v. McColgan, 30 Cal, 2d 472, 473-474 (1947) the court said: "However, accepting as we must, the application of the law to unincorporated wholly-controlled branches or businesses located in other jurisdictions as set forth in Butler Brothers v. McColgan, 17 Cal, 2d 664 (111 P.2d 334), 315 U.S. 501 (62 S. Ct. 701, 86 L. Ed. 991), the conclusion is irresistible that the same rule should apply to incorporated wholly-controlled branches or businesses so located," Contrary to Appellant's contention, tax evasion was not a factor in the court's decision (see p. 482). Nor can we see any reason for applying a different rule merely because the affiliated corporation is organized under the laws of Canada rather than under those of one of the states of the United States, Appellant states that there might in some countries be problems of currency restrictions and property valuation although it admits that such problems are not significant in so far as Canada is concerned. We feel that in the-specific context of this case there are no facts which require a different rule to be applied than was applied in the Edison case, supra.

Appellant also argues that the Tax Convention and Protocol between the United States and Canada (proclaimed by the President on June 17, 1942) precludes the action of the Franchise Tax Board because it expresses the policy of the United States Government that separate corporate entities may be disregarded only in the case of improper diversion of income by one corporation to another. This convention is not, however, applicable to the states by its terms nor was it intended to apply to them. A report of the Senate Committee on Foreign Relations recommending that the Senate give its advice and consent to the ratification of certain conventions, including an amendment to the convention with Canada, expressly states:

> "Insofar as the United States is concerned, the various conventions relate only to the income and estate taxes of the Federal Government, ahd they have no effect upon the income, estate, or inheritance taxes imposed by any State, Territory, or possession of the United States or the District of Columbia." (Cong. Record, Vol. 97, Part 9, p. 11435, Sent. 17, 1951.)

While this report specifically concerned an amendment to the convention with Canada, it seems clear to us that it reflects the purpose of the basic convention, as well as the amendment, not to interfere in any way with the practices of the various states in the administration of their tax laws. We conclude, accordingly, that if the business of Appellant and the Canadian Company may be regarded as unitary there is no reason why the Franchise Tax Board should not be sustained,

We now reach the main issue in the appeal - were Appellant and the Canadian Company engaged in a unitary business? The leading California cases dealing with the problem of what is and what is not to be considered a unitary business are Butler Brothers v. McColgan, 17 Cal. 2d 664, aff'd. 315 U.S. 501; and Edison California Stores, Inc. v. McColgan, 30 Cal. 2d 472. Under these cases a business is unitary if the operation of the portion of the business within the State is dependent upon or contributes to the operation of the portion of the business conducted outside of the State.

We think that there was mutual dependence and contribution between the Canadian Company and the rest of the business, including that portion conducted by Appellant within California. Thus, without its connection with Appellant, the Canadian Company would undoubtedly have had to pay more for its raw materials; it would have had to pay more for the can closing machines which it acquired at cost from Appellant; it would not have had the benefit of.the research facilities of Appellant and the other 'subsidiaries> and it would--have been without the executive guidance and managerial "know how" that it received from appellant, On the other hand, the added demand which the Canadian Company furnished increased the purchasing power of Appellant and helped make it possible to obtain higher quality executive and 'research talent. It is clear that Appellant and the' Canadian Company were engaged in a unitary business.

Appeal of American Can Company

ORDER

Pursuant to the views expressed in the Opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the protests of American Can Company to proposed assessments of $5,071.09, $3,501.86, $187.87 and $575.52 for the income years 1946, 1947, 1948 and 1949, respectively, be and the same is hereby sustained.

Done at Los Angeles, California, this 19th day of November, 1958, by the State Board of Equalization

George R. Reilly, Chairman

J. H. Quinn, Member

Paul R. Leake, Member

_____ Member

_____ Member

ATTEST: Dixwell L. Pierce, Secretary